INTERNAL RECONSTRUCTION

STUDENT NOTES

Meaning :- It is process to reorganise the affairs of Company. It is done by :-

1. **Revaluation of Assets.**
2. **Reassessment of Liabilities.**
3. **Reducing the Paid-Up Value of Shares.**
4. **Varying the rights of shareholders**

All of this is done to write off the losses already suffered by the company.

Methods of Internal Reconstruction

Reduction XL → Alter kamar

L

1. Alteration of Share Capital

Sub- division of Share	**Consolidation of Share**	**Conversion of Shares into stock & vice versa**
S.C → FV : 100 × 5000 = 500000 FV : 10 × 50000 = 500000	FV : 10 × 50000 = 500000 FV : 100 × 5000 = 500000 0	234,33,369 Sh. → 1 Stock → % of Hold. 7.5% 50000
Share capital of the company is sub- divided to Shares of Small denomination.	*Share capital of the company is consolidated to Shares of higher denomination.*	*A company can convert its fully paid up share into **Stock*** & vice versa.*
Eq. Sh. Cap. A/c Rs.100) Dr. 500000 To Eq. Sh. Cap. (Rs. 10) A/c 500000 100%	Eq. Sh. Cap. A/c (Rs. 10) Dr. To Eq Sh. Cap. (Rs. 100) A/c	Eq. Sh. Cap A/c (400*10) Dr. 4,000 To, Eq. Stock A/c 4,000

Under both the scenarios amount of Share Capital remains the Same.

***Stock** :- A Stock is a bundle of fully paid Shares, that are consolidated for convenience, so that it may be divided into any amount and transferred into any fractions without regard to the original face value of shares.*

2. Variation of Shareholders' Rights.

Where a company has two different classes of Shares , the company can vary the Rights of any Class of Share.

***Example:-** (i) Rate of dividend may be changed.*
(ii) Voting Rights may be changed.
(iii) Cumulative Shares may be converted into non- cumulative share

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Internal Reconstruction :- company → loss making
↓
Books of Accounts → Balance Sheet
↓
Restructure → present paap → khatam

In this chapter, we are going to learn how to restructure / reconstruct the balance sheet.

B/S

S.C. 2cr. −0.5 = 1.5cr.
R&S. → (8 cr.)
+ 7.5
(0.5)

Bankloan Reduce by 50L { 1cr. 50L

Tradepayables Reduce by 1cr. { 1.5cr. 50L

Assets : Land 2cr. → Sale Value = 20cr. — Increase by 18cr. ✓

Building 5cr. → sale value = 3cr. — Reduce by 2cr. ✓

Goodwill
BV = 10cr. → 0 — Reduce by 10cr. ✓

+ 18cr.
− 2cr.
− 10cr.
+ 50L
+ 1cr.
7.5 crores → faeda → paap mita sakta hai
+ 0.5
8.0 crores

Internal Reconstruction
↓
first approval of all concerned parties.
↓
Court → approval
↓
Scheme of Internal Reconst. can be implemented.

A XL → A XL

$\boxed{FV = 100}$ → $\boxed{FV = 100}$

$\boxed{PUV = 100}$ → Loss = 90 → PUV = 10

Share Capital Dr 90
To, Profit 90

XL

$\boxed{FV = 100}$ A → $\boxed{FV = 10}$

A

$\boxed{PUV = 100}$ → Loss = 90 → PUV = 10

Share Capital (100)	Dr.	100
To, Share Capital (10)		10
To, Profit		90

METHODS OF INTERNAL RECONSTRUCTION

1. Alteration of Share Capital

Sub Division of Shares

O	N
FV = 100	FV = 10
No = 10000	No = 100000
SC = 1000000	SC = 1000000

Equity Share Capital (FV = 100) Dr. 1000000
To, Equity Share Capital (FV = 10) 1000000

Consolidation of Shares

O	N
FV = 10	FV = 100
No = 100000	No = 10000
SC = 1000000	SC = 1000000

Equity Share Capital (FV = 10) Dr. 1000000
To, Equity Share Capital (FV = 100) 1000000

Conversion of Shares in Stock & Vice-Versa

Equity Share capital Dr. 1000000
To Equity Stock 1000000

2. Variation in Shareholder Rights

→ Dividend Rights changed.
- Rate of Dividend
- Cumulative → non-cumulative

→ Voting Rights.

3. Reduction in Share Capital

Cancelling the right for uncalled capital.

FV = 10 (XL) → FV = 8 (L)
PU = 8 PU = 8

Right to call ₹2 → giveup.

Equity Share Capital (FV = 10) Dr. 8
To, Equity Share Capital (FV = 8) 8

Repay the excess capital called

FV = 10 (XL) FV = 8 (L)
PU = 10 PU = 8
Repay = 2

Equity Share Capital (FV = 10) Dr 10
To Equity Share Capital (FV = 8) 8
To, Shareholders / Bank 2

Reducing the paidup capital i.e. lost/unrepresented

Only paidup value is reduced

FV = 10 (XL) FV = 10 (XL)
PU = 10 → L = 9 PU = 1
FV continues to be ₹10
Equity Share Capital Dr. 9
To, Capital Reduction (Profit) 9

Both facevalue and paidup value are reduced.

FV = 10 (XL) FV = 1 (L)
PU = 10 → L = 9 PU = 1
FV changes from 10 to 1
Equity Share Capital (FV = 10) Dr. 10
To, Equity Share Capital (FV = 1) 1
To, Capital Reduction (Profit) 9

4. Compromise / Arrangements

with creditors, bank loan, debentures etc.

Eg :- Debentures = 500000 → 250000 giveup (assumed), 250000 Equity Shares

5. Surrender of Shares

a. Alteration :-

O	N
FV = 100	FV = 10
No = 10000	No = 100000
SC = 1000000	SC = 1000000

Shareholders will surrender their 40/50/60% shares towards the company.

↓

Company will use these shares to pay off their liabilities. Any excess shares left with the company will be finally cancelled.

STUDENT NOTES

FV 100 No 1000 → FV 10 No. 10000 → XL 100000

FV 10 No 1000 → FV 10 No. 1000 → L 10000

Share Capital A/c (old rights) A/c Dr. xx
To Share Capital A/c (new rights) A/c xx

3. Reduction of Share Capital.

FV = 10, PV = 8 → liab. call = 2 → future → X unpaid

FV = 8, PV = 8

1. Extinguishing /Reducing Liability for unpaid amount.

E.g. Partly Paid–up Shares Rs 7.5 each converted into fully paid-Up Share Rs 7.5/-

Share Capital (Rs.10) (partly Paid-Up) Dr. 7.5
To Share Capital (Rs 7.5) (Fully Paid up) 7.5

FV = 10, PV = 10 → FV = 8, PV = 8, repay = 2

2. Paying off any excess Capital.

E.g. Fully Paid –up Shares Rs.10 each, Rs.2/Share paid off to make fully paid up Share Rs.8 each

Share Capital (Rs.10) Dr. 10
To, Share Capital (Rs.8) A/c 8
To, Shareholders A/c 2

Shareholders 2
To, Bank 2

3. Cancelling the Paid –up capital that is lost or not represented.

Only Paid–Up Value is Reduced.

Example:- Nominal value = Rs.100/share.

Paid-up Value Reduced by Rs.90/share.

FV = 10

Share Capital A/c Dr. 90
To Capital Reduction A/c 90

- **Only Paid-up Value is reduced .**
- **Nominal value /share continues to be the same.**

S.C → FV = 100, PUV = 10

XL: FV = 10, PU = 10 → lost = 6 → reduce; not represented

B/s: SC (PUV) 10 | A 10; A 4; L 6

XL: FV = 100, PV = 100 − 90 = 10

Both Nominal and Paid-Up is reduced.

Example:- Nominal value and Paid-up Value both Reduced by Rs.90/Share.

Share Capital A/c (Rs.100) Dr. 100
To Share Capital A/c (Rs.10) 10
To Capital Reduction A/c 90

- **Paid-up Value & Nominal value /share gets reduced.**

XL: FV = 100, PUV = 100 → lost = 90 → L: FV = 10, PUV = 10

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Creditors Bank loan

500000 — 250000 → gayab

250000

ESC

STUDENT NOTES

4. Compromise/Arrangements.

Agreements between company and its Shareholders or Outside liabilities

Shareholders give up claim to reserves or accumulated profits.
Reserves /profits A/c Dr.
To, Capital Reduction a/c

Settlement with Liability for lesser amount.
Outside Liabilities A/c Dr.
To, Capital Reduction a/c

5. Surrender of Shares.

In this method ,Share are first divided into shares of smaller denominations and Shareholders are then made to surrender their shares to the company.
These Shares are then issued to outside liabilities to reduce their claim.
The unutilized surrendered Shares are cancelled by transferring to Capital reduction A/c.

Special Points:- Shares Surrender

(1) FV = 100 Number = 100000
↓
FV = 10 Number = 1000000 } Alteration
↓
50% shares surrender → give up.
↓
500000 sh.

Trade payables → 100000 sh.
Bank loan → 150,000
Debentures → 200000
50000 → Shares cancel.

In the books of Weale ltd.

	Particulars		Dr.	Cr.
1.	Equity Share Capital (₹100)	Dr.	10000000	
	To Equity share Capital (₹40)			4000000
	To Capital Reduction a/c (Profit)			6000000
	↓ Capital Reconstruction a/c			
2.	12% Preference share Capital (₹100)	Dr.	5000000	
	To 12% Preference Share Capital (₹60)			3000000
	To Capital Reduction (Profit)			2000000
3. a.	10% Debentures (100)	Dr.	4000000	
	To 12% Debentures (100)			4000000
b.	12% Debentures (100)	Dr.	4000000	
	To 12% Debentures (70)			2800000
	To Capital Reduction (Profit)			1200000
4. a.	Creditors	Dr.	800000	
	To Capital Reduction (Profit)			800000
b.	Creditors	Dr.	1200000	
	To Equity share capital (FV=40)			1200000
5.	Capital Reduction	Dr.	3750000	
	To Fixed Assets			3750000
6.	Capital Reduction (Loss)	Dr.	5500000	
	To Current Assets			5500000
7.	Provision for taxation	Dr.	100000	
	Capital Reduction (Loss)		50000	
	To Bank			150000
8.	Capital Reduction	Dr.	50000	
	To Investments			50000

Capital Reduction bal = 650000

	Particulars		Dr.	Cr.
9.	Capital Reduction	Dr.	650000	
	To P&L			600000
	To Capital Reserve (bal.)			50000

The balance of Capital Reduction will be used to w/off the accumulated losses (i.e. Dr. balance of P&L) even if it is not mentioned in the question. It is compulsary to pass the above effect.

After writing off the Dr. bal of P&L if there is any balance in Capital Reduction, the same will be transferred to Capital Reserve a/c

STUDENT NOTES

The following scheme of reorganization is sanctioned:

(i) All the existing equity shares are reduced to ₹ 40 each.

(ii) All preference shares are reduced to ₹ 60 each.

(iii) The rate of interest on debentures is increased to 12%. The debenture holders surrender their existing debentures of ₹ 100 each and exchange the same for fresh debentures of ₹ 70 each for every debenture held by them.

(iv) One of the creditors of the company to whom the company owes ₹ 20,00,000 decides to forgo 40% of his claim. He is allotted 30,000 equity shares of ₹ 40 each in full satisfaction of his claim.

20L − 40% = $\boxed{800000}$

Bal = 1200000

30000 x 40 = 1200000 (E-S)

(v) Fixed assets are to be written down by 30%.

(vi) Current assets are to be revalued at ₹ 45,00,000.

(vii) The taxation liability of the company is settled at ₹ 1,50,000.

(viii) Investments to be brought to their market value.

(ix) It is decided to write off the debit balance of Profit and Loss account.

Pass Journal entries and show the Balance sheet of the company after giving effect to the above. **(notebook page no.)**

Question 6 **Category:-**

The summarized Balance Sheet of M/s. Ice Ltd. as on 31-03-2015 is given below

Liabilities	₹	Assets	₹
1,00,000 Equity shares of ₹ 10 each fully paid up	10,00,000	Freehold property	5,50,000
4,000, 8% Preference shares of ₹ 100 each fully paid	4,00,000	Plant and machinery	2,00,000
6% Debentures 4,00,000 (secured by freehold property)		Trade investment (at cost)	2,00,000
Arrear interest 24,000	4,24,000	Trade receivables	4,50,000
Trade payables	1,01,000	Inventories-in trade	3,00,000
Director's loan	3,00,000	Profit and loss account	5,25,000
	22,25,000		**22,25,000**

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective stakeholders: